

**RULES
OF
DEPARTMENT OF REVENUE
INCOME TAX DIVISION**

**Chapter 560-7-3
SUBSTANTIVE REGULATIONS**

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560-7-3-.04 Captive Real Estate Investment Trust Expenses and Costs.

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(1) **Purpose.** The purpose of this regulation is to provide guidance with regard to the administration of O.C.G.A. § 48-7-28.4, which requires the taxpayer to add back certain captive real estate investment trust (REIT) expenses and costs. For purposes of this regulation, such expenses and costs shall be referred to as captive REIT costs and the captive real estate investment trust shall be referred to as the captive REIT.

(2) **General Guidelines.** The Department requires all direct and indirect captive REIT costs to be added back to income prior to claiming an exception to the addback adjustment. Any person that paid, accrued, or incurred such captive REIT costs must complete Form IT-REIT.

(3) **Direct and Indirect Expenses.** If an expense that is paid, accrued, or incurred by a taxpayer is related, directly or indirectly, to a captive REIT cost paid, accrued, or incurred, directly or indirectly, by or for any other related member, it is an indirect

captive REIT cost and as such is required to be added back as provided in O.C.G.A. § 48-7-28.4. For example:

(a) Corporation C is a captive REIT with respect to Corporations A and B. Corporation A is a Georgia taxpayer that pays rent to Corporation B. Corporation B makes captive REIT cost payments to Corporation C. To the extent the captive REIT costs which Corporation B pays to Corporation C are directly or indirectly included in the rent Corporation A pays to Corporation B, the direct captive REIT costs of Corporation B are considered to be indirect captive REIT costs of Corporation A. As such, for purposes of O.C.G.A. § 48-7-28.4, Corporation A is deemed to indirectly pay captive REIT costs to Corporation C that are subject to the addback adjustment.

(b) Corporation C is a captive REIT with respect to Corporations A and B. Corporation A is a Georgia taxpayer that purchases products from Corporation B. Corporation B makes captive REIT cost payments to Corporation C. To the extent the captive REIT costs which Corporation B pays to Corporation C are directly or indirectly included in the costs of the products or services Corporation A purchases from Corporation B, the direct captive REIT costs of Corporation B are considered to be indirect captive REIT costs of Corporation A. As such, for purposes of O.C.G.A. § 48-7-28.4, Corporation A is deemed to indirectly pay captive REIT costs to Corporation C that are subject to the addback adjustment.

(c) Corporation C is a captive REIT with respect to Corporations A and B. Corporation A is a Georgia taxpayer that pays a management fee to Corporation B. Corporation B makes captive REIT cost payments to Corporation C. To the extent the captive REIT costs which Corporation B pays to Corporation C are directly or indirectly included in the costs of the management services Corporation A purchases from Corporation B, the direct captive REIT costs of Corporation B are considered to be indirect

captive REIT costs of Corporation A. As such, for purposes of O.C.G.A. § 48-7-28.4, Corporation A is deemed to indirectly pay captive REIT costs to Corporation C that are subject to the addback adjustment.

(4) **Authority to Reverse Adjustment.** Subsection (d) of O.C.G.A. § 48-7-28.4 provides that the Commissioner shall have the authority to reverse in whole or in part the adjustments required by subsection (b) of O.C.G.A. § 48-7-28.4 when the taxpayer and the Commissioner agree in writing to the application or use of an alternative method of apportionment under subparagraph (d)(2)(C) of O.C.G.A. § 48-7-31, O.C.G.A. § 48-7-35, or O.C.G.A. § 48-7-31.1. Except with respect to O.C.G.A. § 48-7-31.1, taxpayers that wish to request such permission from the Commissioner shall file an application, petition, or request with the Commissioner at least ninety (90) days prior to the due date of the Georgia return (including extensions) or at least ninety (90) days prior to the filing of the return, whichever occurs first, for the tax year for which such application or use of an alternative method of apportionment is requested. Failure to request permission by such time will result in the filing of income tax returns subject to the regular apportionment methods for the applicable tax year. Except with respect to O.C.G.A. § 48-7-31.1, the reversal of the adjustment shall be applied:

(a) Only in those cases where unusual fact patterns occur that are unique and which will produce incongruous results based upon standard allocation and apportionment provisions; and

(b) Only when the taxpayer establishes by clear and convincing evidence that the taxpayer's proposed allocation and apportionment method would more clearly reflect the income attributable to the trade or business within Georgia.

(5) Exception for Income Allocated or Apportioned to and Taxed by Georgia or Another State. The various factors of the exception for income allocated or apportioned to and taxed by Georgia or another state are set forth below:

(a) Subsection (e) of O.C.G.A. § 48-7-28.4 provides that the adjustment required by subsection (b) of O.C.G.A. § 48-7-28.4 shall be reduced, but not below zero, to the extent the corresponding captive REIT costs paid, accrued, or incurred by the taxpayer are received as income in an arm's length transaction, as defined below in subparagraph (5)(c)5.(i), by the captive REIT and the amount to be included in the income base is allocated or apportioned, or both, to and taxed by Georgia or another state that imposes a tax on or measured by the income of the captive REIT. For purposes of this paragraph, the corresponding expenses and costs shall not be considered to have been received as income by the captive REIT to the extent such income is reduced, in computing the income of the captive REIT in Georgia or another state, by the dividends paid deduction or by expenses paid, accrued, or incurred by the captive REIT to persons that are not related members, or both. For example:

1. A taxpayer doing business in Georgia expenses \$5,000,000 in captive REIT costs. The captive REIT files a return in State A. The captive REIT's apportionment ratio in State A is 75%. The captive REIT has no dividends paid deduction and no expenses paid, accrued, or incurred to persons that are not related members. Applying the apportionment ratio to the income of the captive REIT results in \$3,750,000 of the captive REIT's income being apportioned to and taxed in State A. Subtracting the \$3,750,000 from the \$5,000,000 results in the taxpayer making an addback adjustment for Georgia purposes of \$1,250,000.

2. A taxpayer doing business in Georgia expenses \$5,000,000 in captive REIT costs. The captive REIT files a return in State B.

The captive REIT's apportionment ratio in State B is 75%. However, the captive REIT has a dividends paid deduction of \$2,500,000 and expenses paid, accrued, or incurred to persons that are not related members of \$2,000,000, both of which reduce the income to \$500,000. Applying the apportionment ratio to the income of \$500,000 results in \$375,000 of the captive REIT's income being apportioned to and taxed in State B. Subtracting the \$375,000 from the \$5,000,000 results in the taxpayer making an addback adjustment for Georgia purposes of \$4,625,000.

3. A taxpayer doing business in Georgia expenses \$5,000,000 in captive REIT costs. The captive REIT does not file returns in any state. However, the taxpayer is required by State C to adjust their income for such captive REIT costs. Assume this results in the taxpayer decreasing their expense in State C by \$2,500,000. Since it is the taxpayer itself and not the captive REIT that is being taxed by State C, the addback adjustment for Georgia purposes is not reduced and is equal to \$5,000,000.

(b) To the extent a taxpayer is deemed to indirectly pay captive REIT costs as provided in paragraph (3), the taxpayer shall be eligible for this exception only to the extent such captive REIT costs indirectly received by the captive REIT meet the requirements of this exception. For example: Assume the same facts as those in the example in subparagraph (3)(a). The exception would only be available if the captive REIT costs deemed to be paid by Corporation A to Corporation C are received as income in an arm's length transaction by Corporation C and such income is allocated or apportioned, or both, to and taxed by Georgia or another state that imposes a tax on or measured by the income of Corporation C.

(c) When a taxpayer seeks to claim the exception provided by subsection (e) of O.C.G.A. § 48-7-28.4, the taxpayer must attach a

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copy of Form IT-REIT and any applicable schedules to its tax return and provide the following information on the Form IT-REIT (with all supporting documentation to be made available upon request):

1. The name and federal identification number of the captive REIT(s);
2. The name of each state and type of tax paid;
3. The amount of the captive REIT costs;
4. The amount of captive REIT costs subject to apportionment and/or allocation and reduced by the dividends paid deduction and by expenses paid, accrued, or incurred to persons that are not related members, the apportionment ratio, and the amount of income apportioned after applying the ratio for each state for such captive REIT;
5. A brief description of the arm's length status of the transactions between the taxpayer and the captive REIT. However, a more detailed description needs to be made available upon request or upon audit. The following shall apply with respect to such detailed description:
 - (i) The taxpayer must establish and substantiate by a preponderance of evidence that the amount of the cost or expense in question was substantially identical to what would be expended in an arm's length transaction under substantially similar circumstances. "Arm's length" is the amount of consideration that would be paid or received in a transaction between unrelated persons, whereby neither person is under any compulsion to enter into the transaction and each person has reasonable knowledge of all relevant facts. This arm's length standard is also met if the results of a transaction are consistent with the results unrelated

taxpayers would have had if they had engaged in the same transaction under the same circumstances;

(ii) For purposes of substantiating that the amount of such expense(s) was at arm's length, a taxpayer who is relying upon an appraisal or a study must identify and make available upon request such appraisal or study and provide the name of the preparer thereof, and state the date on which such appraisal or study was issued and the general conclusions thereof;

(iii) In general, the Commissioner will be more likely to allow an exception when a taxpayer and a captive REIT are not controlled or managed on a day-to-day basis by the same person(s) and the same person(s) did not occupy both sides of the bargaining table. This will be particularly so when the taxpayer and a captive REIT were previously independent entities or, if not previously independent, function like independent entities without interconnected activities or overlapping interests. The taxpayer must indicate whether the taxpayer believes that the transaction was in fact negotiated by the taxpayer and a captive REIT who were dealing with each other on an arm's length basis. At the same time, the Commissioner recognizes that in many controlled-group contexts, a taxpayer and a captive REIT will not in fact conduct arm's length negotiations. If the terms of an agreement between a taxpayer and a captive REIT are substantially the same as those that unrelated parties would have entered into, the fact that the overall organization of which a taxpayer and a captive REIT form a part is centrally managed will not, by itself, preclude relief from the addback provisions;

(iv) The taxpayer must explain and clarify in detail how the captive REIT obtained the assets in question, such as whether the assets were either purchased by the captive REIT from a person that was not a related member or were purchased or received from

a related member in an arm's length sales transaction and whether the assets were legally transferred to the captive REIT; and

(v) Where a taxpayer cannot show by a preponderance of evidence that the amount of the deduction was at arm's length, the Commissioner may adjust the cost or expense to reflect arm's length pricing or, alternatively, may deny the taxpayer's exception claim in its entirety; and

6. Such other information as the Commissioner may prescribe.

(6) Exception for Expenses Paid, Accrued, or Incurred to Persons that are not Related Members. The following provides for the exception for expenses paid, accrued, or incurred by a captive REIT to persons that are not related members.

(a) Subsection (c) of O.C.G.A. § 48-7-28.4 provides that the adjustment required by subsection (b) of O.C.G.A. § 48-7-28.4 shall be reduced, but not below zero, if and to the extent:

1. The captive REIT costs received as income by the captive REIT are reduced by expenses paid, accrued, or incurred to persons that are not related members; and

2. Such expenses are allowed in computing the captive REIT's federal taxable income.

(b) Depreciation shall be considered paid, accrued, or incurred by a captive REIT to persons that are not related members provided the assets on which the depreciation is being claimed were purchased from a person who was not a related member or were purchased or received from a related member in an arm's length transaction and the assets were legally transferred to the captive REIT. The provisions listed in subparagraph (5)(c)5. shall apply with respect to such arm's length determination.

(c) When a taxpayer seeks to claim the exception provided by subsection (c) of O.C.G.A. § 48-7-28.4, the taxpayer must provide the following information on the Form IT-REIT (with all supporting documentation to be made available upon request or upon audit):

1. The amount of the expenses paid, accrued, or incurred by a captive REIT to persons that are not related members;
2. A schedule which provides a breakdown of costs by type of expense;
3. For any depreciation claimed, a representation as to whether the related assets were purchased from a person who was not a related member or were purchased or received from a related member in an arm's length transaction and the assets were legally transferred to the captive REIT; and
4. Such other information as the Commissioner may prescribe.

Authority: O.C.G.A. §§ 48-2-12 and 48-7-28.4.